# In the Supreme Court of the United States

**OCTOBER TERM 1944.**

**No. 342**

In the Matter of
THE HIGBEE COMPANY, Debtor. } BANKRUPTCY No. 36,119

ROBERT R. YOUNG,
*Petitioner,*

vs.

THE HIGBEE COMPANY,
WILLIAM W. BOAG, and
J. F. POTTS,
*Respondents.*

## PETITION FOR WRIT OF CERTIORARI
**To the United States Circuit Court of Appeals**
**For the Sixth Circuit**
**and**
## BRIEF IN SUPPORT OF PETITION.

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## PETITION FOR WRIT OF CERTIORARI
**To the United States Circuit Court of Appeals**
**For the Sixth Circuit.**

*To The Honorable The Chief Justice and Associate Justices of the United States:*

Petitioner Robert R. Young hereby petitions for the issuance of a Writ of Certiorari to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit rendered herein on May 15, 1944.

### STATEMENT OF THE MATTER INVOLVED.

This is a controversy arising out of the corporate reorganization proceedings of The Higbee Company pursuant to Chapter X of the Bankruptcy Act. Petitioner was, at the time of the transaction involved, a holder of First Preferred Stock of The Higbee Company, Debtor. Petitioner still holds the securities which pursuant to the Plan of Reorganization were issued in respect of those shares.

Respondents Potts and Boag were members of a Preferred Stockholders Committee and had appealed to the Circuit Court of Appeals for the Sixth Circuit from the order of the District Court confirming a Plan of Reorganization for Higbee. Potts was also the attorney for the Committee. Potts was the owner of 250 shares, and Boag the owner of 10 shares of the First Preferred Stock of Higbee.

Messrs. C. L. Bradley and J. P. Murphy were directors of Higbee and Bradley was its President. Bradley and Murphy individually held large claims against The Higbee Company. The validity and amount of these claims were the issues involved in the Potts and Boag appeal.

On March 7, 1942 Bradley and Murphy, being anxious that the Plan be approved, paid Potts and Boag $115,000 for their shares which then had a current market value of approximately $15,000. By an express provision in the contract of sale Bradley and Murphy succeeded to the rights of Potts and Boag in the appeal. (R. 223) They forthwith caused the dismissal of the appeal and consequent final confirmation of the Plan of Reorganization, thus avoiding a determination by the Circuit Court of the merits of the questions raised by the appeal. Potts himself characterized the transaction as "selling the appeal." (R. 188)

It is the contention of Petitioner that this transaction was wrongful because it was done by persons occupying a fiduciary capacity, and because it deprived their beneficiaries of an adjudication of important legal questions pertaining to substantive rights. Consequently an order was prayed below directing Potts and Boag to turn over to The Higbee Company for the sole benefit of its first preferred stockholders the $100,000 bonus which they received, that being the difference between the fair market value of the securities sold to Bradley and Murphy and the price received.

The Special Master who heard the case found (R. 242):

> "On November 14, 1941, Potts and Boag, acting on behalf of themselves only, appealed to the United States Circuit Court of Appeals from the order of the United States District Court confirming the Amended Plan of Reorganization of The Higbee Company."

The Circuit Court of Appeals while not rendering an opinion found in its memorandum as follows:

> "And it appearing from the findings of the master, confirmed by the District Court and supported by the evidence, that Potts and Boag represented no other stockholders than themselves and acted only for themselves individually and not as representatives of a class, both in the filing of objections to the confirmation of the amended plan of reorganization and in prosecuting their appeal from the court's order confirming the amended plan of reorganization, and at no time asserted a derivative right belonging to the debtor:" etc.

The Circuit Court of Appeals thus affirmed the judgment of the District Court.

Petitioner agrees that, as the matter turned out, a finding that Potts and Boag were actually acting only for themselves is fully warranted. Had they been acting for those whom they stated they represented, they would have turned over the proceeds of the sale of their appeal for distribution among all the members of the class.

It cannot be disputed, however, that Potts and Boag openly, although apparently in bad faith, held themselves out to be a committee organized for the protection of the preferred stockholders of Higbee. They made statements to this effect in briefs and pleadings filed with the District Court and they circularized the preferred stockholders with letters under the letterhead of "Independent Preferred Stockholders' Committee of The Higbee Company." (R. 172) (The evidence on this score will be more fully analyzed in the brief below.)

The question which must be determined is whether Potts, an attorney, and Boag, who together formed a stockholders' committee, shall be relieved of their obligation to account to their beneficiaries by reason of an undisclosed mental determination that they were acting for themselves only. It is Petitioner's contention that Potts and Boag should be held to accountability by reason of their statements and representations that they were acting in behalf of all stockholders, any undisclosed mental reservations to the contrary notwithstanding. It was on March 7, 1942, the day of the sale to Bradley and Murphy, that Potts and Boag first stated that they were actually acting only for themselves. This mental determination which was contrary to the communications they had sent to the preferred stockholders is the apparent reason why the Circuit Court has affirmed an order of the District Court exonerating Potts and Boag from the duty of accounting for their profit to the members of the class whom they stated they represented. This is the error of which complaint is here made.

## THE QUESTIONS PRESENTED.

1—After Potts and Boag had represented to the Court and to the Higbee Preferred Stockholders that they were acting as a committee in the interests of all preferred stockholders, can they thereafter accept and retain for themselves individually a $100,000 consideration for permitting the dismissal of an appeal which they had taken from a decree confirming the Amended Plan of Reorganization of The Higbee Company?

2—Should Potts and Boag be required to pay over to The Higbee Company for its First Preferred Stockholders the aforesaid $100,000 consideration which they received for permitting the dismissal of the appeal?

## REASONS FOR ALLOWANCE OF THE WRIT.

The Supreme Court should issue the Writ of Certiorari in this case because a question of paramount importance to the fair conduct of reorganization proceedings is presented for determination. A large class of public stockholders was interested in the Higbee proceedings. Respondents Potts and Boag were members of two successive stockholders' committees and as such sent communications to the stockholders. Class representation of this character having a somewhat indefinite inception and being nebulous in character requires the protection of the Court. The transaction in this case represents a trafficking in reorganization proceedings of the most serious nature. The decision in the case permits a class representative to change character and become an individual litigant at any time that it suits his fancy and pocketbook to do so without any notice to the class or even to the Court. This we submit is of paramount importance to the fair conduct of corporate reorganization proceedings.

## JURISDICTION.

The jurisdiction of this Court to grant the Writ is invoked under Judicial Code Section 240 as Amended (Title 28 U. S. C. A. Section 347). The judgment of the United States Circuit Court of Appeals for the Sixth Circuit was rendered May 15, 1944 and this petition is filed within the statutory period (28 U. S. C. A. 350).

## PRAYER FOR RELIEF.

Wherefore the petitioner, by his counsel, prays the issuance of a Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit to the end that

the judgment may be reversed, and for such other relief as to the Court may seem appropriate.

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## BRIEF IN SUPPORT OF PETITION.

### STATEMENT OF FACTS.

At all times since 1937 C. L. Bradley and J. P. Murphy were asserting large claims against Higbee—claims aggregating over $1,500,000—based on certain promissory notes (referred to as the Junior Indebtedness) which they had purchased from George and Frances Ball Foundation for much less than their face value at a time when Bradley was a director of Higbee. (R. 229.)

During and prior to August of 1938, Respondents Potts and Boag were members of the "New Preferred Stockholders' Committee" and as such were objecting to the allowance of the claims filed by Bradley and Murphy on the grounds that the Junior Indebtedness was not a valid debt of Higbee, but should be considered a capital advance; or in the alternative that Bradley and Murphy should not be permitted to claim against Higbee for an amount larger

than the purchase price to Bradley and Murphy of the junior notes (Young Ex. 1, R. 81).

By December 18, 1940 Potts and Boag had resigned from the then existing stockholders' committee. On that day there was a hearing before the Special Master on the Amended Plan of Reorganization and at such hearing Potts announced to the court that he was forming a new stockholders' committee to continue objections to the Plan and to make an application to the court for the appointment of disinterested counsel, as he was then asserting that it was unfair to the preferred stockholders for counsel then acting for the Debtor to continue to do so in view of their reluctance to object to the Bradley-Murphy claims. On that occasion Potts stated to the Master as follows (Young Ex. 18, R. 185):

> "A new stockholders' committee will be formed, and whether or not we call it a new new stockholders' committee, I don't know, but it will have to be given some name so that we can differentiate it from the other stockholders' committee, and I think, after talking with Mr. Ewing, that the objections can be consolidated so that you will have to deal with just one committee in the very near future."

Pursuant to the notification given to the Master, Potts and Boag filed an application for the appointment of special counsel and a brief in support thereof (Young Ex. 5, R. 112, Ex. 6, R. 115).

The Master overruled the objections, and Potts and Boag excepted to the report (Young Ex. 7, R. 121) and filed a brief in support of the exceptions. Again Potts persisted in his objections to the Bradley-Murphy claims and to the compromise thereof proposed in the plan as being unfair to all of the preferred stockholders.

A reply brief of Potts and Boag (Young Ex. 9, R. 146) was submitted to the court in answer to the Debtor's brief which argued in support of the Master's report. This

reply brief makes the following very significant statement (R. 147):

> "SECOND, it has been stated that objectors own and therefore represent only 260 shares of Higbee First Preferred. While we believe that the owner of a single share has as much right to be heard as the owner of many shares, we wish to point out to the court that objectors were originally members of the New Preferred Stockholders' Committee; that objectors resigned from said committee in protest over the unauthorized action of its counsel in approving this Plan. The representation which said New Preferred Stockholders' Committee now claims was acquired mainly through the presence on such Committee of Messrs. Potts and Boag, the present objectors, *and it is now a fact that a very large proportion of the stockholders which the New Preferred Stockholders' Committee claims to represent actually look to these objectors for the protection of their interest.* The two remaining members of that committee are the owners of 10 shares of Preferred Stock each." (Emphasis added.)

On July 10, 1941 Potts and Boag sent a letter (Young Ex. 14, R. 172) to all of the holders of First and Second Preferred Stock of The Higbee Company under the letterhead of "INDEPENDENT PREFERRED STOCKHOLDERS' COMMITTEE OF THE HIGBEE COMPANY." This letter merits careful examination. It begins with the following paragraph (R. 172):

> "The undersigned constitute a Committee organized solely for the benefit of the Preferred Stockholders of The Higbee Company, and to prosecute certain objections to the Amended Plan of Reorganization dated September 27, 1940, filed for The Higbee Company."

The letter then outlines in some detail the objections which were asserted by Potts and Boag to the Bradley-Murphy claim, and recites some of the accomplishments obtained by Potts and Boag on behalf of all preferred stockholders since filing the original objections. Near the close of the letter will be found the following paragraphs (R. 178):

"If you desire any further information, please get in touch with this Committee. Without any obligation whatsoever, you may join in this fight to the finish, in order to get a better deal for the Preferred Stockholders of The Higbee Company.

"This Committee is, and will remain, absolutely independent of the far reaching influences of The Higbee Company management. In case you do not approve this plan, we will be glad to have you so advise us."

Potts was examined at length concerning this letter by Mr. Sherwood of The Securities and Exchange Commission at the hearing on the application of Potts for compensation held May 14, 1942 (Young Ex. 19, R. 185). It there appears that Potts received replies from preferred stockholders to the letter of July 10, 1941, that some of the stockholders "expressed a desire that the objections be prosecuted" and that the stockholders were never given notice that Potts and Boag had discontinued their representation of the interests of the stockholders. Under these circumstances, and in view of the strong and unequivocable language of the letter of July 10, the preferred stockholders were entirely reasonable in their reliance upon the good faith of Potts, an attorney in the proceedings, who had expressed his intention to prosecute the objections to final conclusion. Even Potts was aware of this because he gave the following testimony upon interrogation by Mr. Sherwood (R. 187):

"Q. As far as some of these people who wrote you were concerned though, they might reasonably have thought that the Independent Stockholders' Committee was still representing their interests and continuing in the course indicated in that letter of July 10?

A. That might be true."

On October 2, 1941 Potts and Boag filed objections and exceptions to the confirmation of the Amended Plan of Reorganization (Young Ex. 15, R. 178). In these objec-

tions Potts and Boag continued in their position that the Junior Indebtedness should not be allowed in the hands of Bradley and Murphy for the amounts set forth in the plan. With these objections, Potts and Boag requested and received leave of the court to refile their briefs which had originally been filed in connection with the earlier objections to approval of the plan (R. 181). One of the briefs so refiled was that which is quoted above at page 9 wherein Potts and Boag claimed to represent "a very large proportion of the stockholders." Thus Potts and Boag were continuing to represent stockholders and to take advantage of this representation in any way that they could before the court.

After the judgment of the District Court on October 17, 1941 confirming the plan Potts and Boag filed notice of appeal (Young Ex. 16, R. 181). In their statement of points (Young Ex. 17, R. 182) Potts and Boag, appellants, continued their vigorous opposition to the allocation in the plan of the new notes and common stock to the old Junior Indebtedness claimed by Bradley and Murphy. This was not, however, the only ground for appeal.

As a part of the record on appeal Potts designated his statement made at the hearing of December 18, 1940 (Young Ex. 18, R. 184) of which a portion was quoted *supra* on page 8. Thus Potts represented to the Circuit Court of Appeals that he was acting in a representative capacity in connection with the appeal on behalf of all stockholders.

*Thus until the very sale of their stock Potts and Boag consistently held themselves out as being the champions of the rights of all preferred stockholders and as the actual representatives of a large number of them. This representation was made to the Master, to the District Court, to the Circuit Court of Appeals and to the preferred stockholders themselves.*

Suddenly, however, Potts and Boag were confronted with an urgent desire upon the part of Bradley and Murphy to acquire the Potts and Boag stock. It became apparent that this stock then occupied a bargaining or nuisance value far in excess of intrinsic value. Potts and Boag could see great monetary gain to them if they could abandon the persons whom they were then representing and shift their position to that of individual litigants. After March 3, 1942 when the first contact was made by Bradley and Murphy, Potts and Boag quickly and without notice to any court or any shareholders shifted their position and asserted for the first time that they were acting in their individual interests and without regard for the interests of any other stockholders. The shift was purely a mental one as there were no outward manifestations. The persons whom they had so fervently represented prior to that time were suddenly abandoned and the appeal was sold out without any consideration being given to the interests of those theretofore represented.

On March 7, 1942 Bradley and Murphy purchased from Potts and Boag 260 shares of First Preferred Stock of the Debtor for a purchase price of $115,000. The approximate market value of the shares on that date was $15,000. The sale of the Potts and Boag stock to Bradley and Murphy was admittedly a sale of the appeal. This is conclusively established by the contract of sale (Young Ex. 26, R. 223) as well as the testimony of Potts (Young Ex. 19, R. 185) taken upon an examination by Mr. Sherwood of the Securities and Exchange Commission.

"Q. Will you tell us the circumstances under which that appeal was dismissed?

A. Well, Mr. Boag's stock and the stock in my name was sold to Messrs. Bradley and Murphy.

Q. For how much was it sold?

A. I don't mind answering it, but I will answer it under objection because it is entirely immaterial.

The Master: I think it is material in this proceeding and I think you may answer. Objection overruled.

A. The total amount was $115,000.

Q. Was that paid in cash?

A. Most of it.

Q. How much of that amount was paid to Mr. Boag?

A. Twenty thousand dollars.

Q. And the balance to you?

A. Yes, sir. I want an objection and exception to all these questions.

Q. The total amount of stock that you and Mr. Boag sold to Mr. Bradley and to Mr. Murphy was 260 shares; is that correct?

A. That is correct.

Q. That would mean that it had a par value of $26,000?

A. That is correct.

Q. Have you any idea what the market value of it was at that time?

A. From sixty to sixty-five.

Q. Have you any idea what induced anybody to pay $115,000 for stock with a par value of $26,000 and a market value considerably less?

A. I think there was a desire to end this litigation.

Q. So that in a sense you were selling something more than your stock, I take it?

A. I think so.

Q. You were selling the appeal which you had taken in behalf of yourself and Mr. Boag; that is a fair statement, isn't it?

A. I think so.

Q. Was the appeal, that you and Mr. Boag took, a part of the program that was outlined to the preferred stockholders in your letter of July 10?

A. It might have been a part of it. The objections, I think, confirmed what we said we would object to.

Q. Were there any other people interested in buying this stock at the time that you sold it to Mr. Bradley and to Mr. Murphy?

A. No; I don't think so.

Q. Mr. Young wasn't interested?

A. Apparently not."

Potts desired to make an even greater profit out of his position in Higbee so he filed an application for an allowance of compensation upon the theory that he had performed a great service on behalf of all stockholders. It must be remembered that this was after the sale of his stock—and the appeal—to Bradley and Murphy but before anyone had suggested that he should account for the bonus he had theretofore received. At the hearing on his application, Potts was interrogated about the "Independent Preferred Stockholders' Committee" which he had theretofore formed. The following is an excerpt from his testimony (R. 185-6):

"Q. Now, after you left the New Preferred Stockholders' Committee you formed another committee, didn't you?

A. I don't know as you could call it another committee. We didn't do anything about forming another committee until after the plan was approved, I think, July 2, 1941.

Q. What did you do then?

A. Sent out a letter to the stockholders.

Q. What was the letterhead?

A. Independent Stockholders' Committee.

Q. And the signature to that communication was also Independent Preferred Stockholders' Committee, wasn't it?

A. That is right.

Q. By whom?

A. Boag, Joecken and Potts.

Q. So that you represented at least that a new Preferred Stockholders' Committee had been formed, did you not?

A. That is right.

Q. What became of that committee?

A. Well, after the plan was confirmed Mr. Boag and Mr. Potts were the only ones that were willing to press our objections any further and that probably was the end of the committee other than whatever was left of it represented by Boag and Potts.

Q. Well, now, did you receive any replies to this communication that you sent out on the letterhead of the Independent Preferred Stockholders' Committee?

A. A few, yes.

Q. Did any of the stockholders who replied express any interest in having this committee represent them?

A. Well, some of them expressed a desire that the objections be prosecuted.

Q. Were they ever given any notice that this committee had been dissolved?

A. No; they weren't."

* * * * *

"Q. Was the appeal, that you and Mr. Boag took, a part of the program that was outlined to the preferred stockholders in your letter of July 10?

A. It might have been a part of it. The objections, I think, confirmed what we said we would object to."

At that hearing Mr. Sherwood of the Securities and Exchange Commission stated the position of the Commission as follows (R. 192):

"It is perfectly plain from Mr. Potts' testimony that he was not only selling the stock, he was selling an appeal, and it can be drawn from that testimony that other people than Mr. Potts and Mr. Boag were interested in that appeal. Whether we call it a class action, anything that resulted from that appeal, except selling it in this way, would have inured to the benefit or the detriment, however it might work out, of the whole class of stockholders.

"I don't think that this Court should be called upon to approve a transaction involving the sale of an appeal, which is what, to a substantial extent, this amounts to. It was also, of course, a sale of stock.

It seems to me that where others are interested in an appeal the sale of the appeal in that way is an unconscionable action.

"One other thing. The action of the Circuit Court of Appeals in dismissing this appeal does not necessarily force the conclusion that the Court concluded that it was an individual appeal and that others were not interested in it. * * * Under these circumstances, it may well be that in some other Court, at some other time, some or all of the preferred stockholders, including those who may have thought that Mr. Potts, in sending out a letter on the letterhead of the Independent Preferred Stockholders' Committee, was representing their interests, have some right to an accounting for what Mr. Potts cleared in this transaction over and above the fair value of the stock that he sold."

The Master also expressed his views in his report recommending denial of any compensation to Potts, and denial of an application which Potts had filed requesting approval of the sale to Bradley and Murphy (Young Ex. 20, R. 194, 195):

"The testimony of Potts is that he did not consider the sale price of his stock to contain any compensation for services rendered by him in the proceeding, although such recovery was realized in the course of the settlement of the appeal. In such recovery the preferred stockholders, including those who responded to his appeal for support, have not shared although obviously they would have shared in any benefits which might have accrued if the appeal had been successfully prosecuted to a conclusion."

Potts took exceptions to the report of the Special Master recommending denial of compensation (Young Ex. 21, R. 198), and in his brief in support of the objections and exceptions (Young Ex. 22, R. 199) he reverts once again to his contention that he was representing the interest of all of the preferred stockholders. Thus he says in his brief (R. 203):

"Applicant J. Fred Potts fought for the above amendments and we submit that those accomplishments which inured to the benefit of all the First Preferred Stockholders, don't reflect that Mr. Potts was looking after his own interests alone. We don't deny that Mr. Potts was looking after his family's interest in Higbee. He spent his own money and gave of his time freely for several years as a member of the New Preferred Stockholders Committee without the slightest hope of being reimbursed or compensated, and that is more than can be said for Messrs. Bloomfield and Orr who now accuse Potts of having had nobody's interest at heart but his own."

Thus we see that Potts shifted his position back again and once more claims to be the champion of the interests of preferred stockholders other than himself.

Potts' application for compensation from the Debtor's estate was disapproved for the reason, among others, that the sale of his stock had not been approved by the court as was required by Chapter X, Section 249 of the Bankruptcy Act. Thereupon Potts filed an application for approval of the sale to Bradley and Murphy and the Master also recommended that this be denied (Young Ex. 20, R. 194).

The Securities and Exchange Commission filed a memorandum with the District Court opposing the applications of Potts for compensation and for approval of the sale to Bradley and Murphy (Young Ex. 24, R. 216). The District Court filed its memorandum on September 3, 1942 adopting the recommendations of the Master and thus refusing to allow Potts any compensation or to approve the sale of the Potts and Boag stock to Bradley and Murphy. The Court, after reciting the facts of the sale, stated the following (Young Ex. 25, R. 220):

"There is no justifiable basis in these circumstances upon which the Court could bottom its approval of the settlement sale of this stock, nor does there appear any just reason for allowing compensation to these appli-

cants upon the theory that they performed services beneficial to the estate or in furtherance of the reorganization. The plain fact is that no such additional burden should be imposed upon the debtor and its creditors and shareholders who accepted the plan, and this is so independently of the prohibition of Section 249 of the Bankruptcy Act. The clear purpose and implications of that provision are sufficient to support rejection, but the bankruptcy court's powers, quite aside from that section are adequate to deny any such approval or allowance. I think that the Master's report and the brief of the Securities and Exchange Commission fully and adequately respond to the application for approval of the settlement sale, as well as to the application for compensation. Nothing is to be gained by a restatement of the ground for denial of both applications. Upon the conceded facts, I can find no ground upon which to sustain the exceptions to the Master's report, and they are accordingly denied and the report confirmed."

Thus the District Court refused to approve the sale.

## ARGUMENT.

The foregoing constitute the essential facts which should be considered by the court in this case. The Master went far outside of the record in his discussion, most of which seems totally irrelevant to the issues presented in the case. Young has instituted this proceeding because he feels, as does the Securities and Exchange Commission, that the preferred stockholders of Higbee suffered a serious wrong when their representatives "sold" the appeal. Young can gain nothing from recovery in this case except a small amount which would inure to a few shares of preferred stock which he owns. Yet the Master devoted most of his report to a new discussion of the history of the Ball sale to the Young syndicate, the subsequent Ball sale to Bradley and Murphy of the Higbee securities and ensuing litigation. All this has nothing to do with the question of whether Potts and Boag are or are not entitled to keep the

bonus they received when they sold out the interests of the hundreds of Higbee preferred stockholders.

It has been demonstrated above that Potts and Boag stated to all concerned that they were acting on behalf of stockholders generally and not just for themselves. The very nature of their objections was such that had they successfully litigated them to conclusion, the benefits would have inured to the Debtor and all preferred stockholders. The principal objection asserted was that the Bradley-Murphy claim either be eliminated as an indebtedness or greatly reduced. Obviously the Debtor would have benefited by the reduction in its total debt which Potts and Boag were endeavoring to bring about. The very nature therefore of the claim asserted was one calculated to benefit not just Potts and Boag, but the Debtor and all preferred stockholders. It was a claim which could not be asserted by a single stockholder solely on his own behalf whether he claimed to represent others or not.

In this respect the situation is analogous to a stockholder's suit wherein a single stockholder sues to recover assets which he claims rightfully belong to the corporation. This type of suit can be brought only in the interest of the corporation whether or not the stockholder bringing it purports to be acting alone or in a representative capacity.

The situation here goes even further. Bradley and Murphy were in control of the policies of the Debtor. They were also asserting large claims against it. Debtor's attorneys for years never filed objections to these claims although Potts and Boag did so as early as 1938. Potts and Boag bitterly complained of the failure by Debtor's attorneys to file appropriate objections. They thus admitted that the objections should properly be made on behalf of the Debtor and that the Debtor and its preferred stockholders were the true parties interested.

As was stated in *Alexander v. Quality Leather Goods Corp.*, 269 N. Y. Supp. 499 (Sup. Ct. N. Y. 1934):

> "When a minority stockholder brings an action on behalf of himself and on behalf of other stockholders similarly situated, he exercises a derivative right and judgment must ordinarily be rendered in favor of the corporation, though the corporation be a defendant in the action."

Similarly in *Curtiss v. Wilmarth*, 254 Mich. 242, 236 N. W. 773 (Sup. Ct. Mich. 1931), the court discussed the nature of an action by a stockholder saying:

> "A suit by a stockholder is in fact a suit by the corporation to redress a wrong to the corporation, and the relief granted belongs to the corporation and not to the stockholder individually. He is not entitled to the money recovered. That goes to the corporation and not to the individual complainants."

Bradley and Murphy as claimants to the old junior notes were interested in a plan of reorganization which would give them the largest participation possible in the reorganized company. Similarly the preferred stockholders were interested in obtaining as large a participation as possible. The plan provided for $600,000 of notes to go to the old junior debt together with the majority of the common stock. Bradley and Murphy paid members of a preferred stockholders' committee a bonus of $100,000 in order to see this plan go through. Perhaps the parties to the transaction felt that they could avoid scrutiny because representation of stockholders generally in matters of this kind is less definite and concrete than the usual representation by an attorney of a single party litigant. However, for that very reason, if for none other, the court should more closely scrutinize the transaction so that the rights of the poorly represented stockholders will be amply protected. The making of a deal of this kind with the attorney and representative of stockholders is no less

subject to criticism and appropriate court action than would be a payment by a litigant to the attorney for his adversary to cause the attorney to discontinue the litigation.

If the proceeds of the Potts and Boag appeal would have inured to the Debtor and its First Preferred Stockholders then the proceeds of the settlement of that appeal should likewise inure to the benefit of the Debtor and its First Preferred Stockholders. There is no logical distinction between the proceeds of the litigation itself and the proceeds of the settlement of litigation. A decree directing Potts and Boag to turn over the $100,000 bonus is the proper remedial device.

The instant case is a flagrant example of misconduct. Potts and Boag were members of two committees. They solicited the right to represent all stockholders (R. 172-8). They urged upon the court that they represented stockholders generally. They urged meritorious objections to the plan on behalf of all stockholders. Bradley and Murphy, fearing that Potts and Boag would successfully bring about a great reduction in, or elimination of, their claim with subsequent advantages to the preferred stockholders, paid the price for settlement, knowing full well that the payment would remain in the pockets of Potts and Boag and would not reach those they represented by any voluntary route. It is time here that the Court condemn this trafficking in litigation with all of its ramifications and the inherent evils which arise as a result of the possibility of such conduct. To permit a sale of an appeal under these circumstances, and thus create a precedent, would be a serious blow to the subsequent fair and ethical conduct of corporate reorganization proceedings.

Even more serious is the instant situation where the payment was made in such a manner that a final adjudication resulted, thus preventing any other security holder from presenting the matter for a judicial determination. Potts and Boag appealed from a judgment of the District

Court. After the time within which any others could bring an appeal the payment was made under a contract (R. 223) which specifically provided for the dismissal of the appeal. To the knowledge of all parties concerned, no appeal by any other was then possible. Thus did the matter result in a final adjudication without any hearing on the merits. Surely under these circumstances the preferred stockholders are entitled to the proceeds of the settlement of the litigation brought on their behalf.

The duty of the Court is to protect these security holders who were so poorly represented. In *Gruenwald v. Moir Hotel Co.*, 96 Fed. (2) 932 (C. C. A. 7, 1938), the court said:

> "Under the Bankruptcy Act, the bondholders' committee, the depository and its officers were all subject to the jurisdiction of the District Court in the reorganization proceedings."

Similarly in *Steere v. Baldwin Locomotive Works*, 98 Fed. (2) 889 (C. C. A. 3rd, 1938), the court said:

> "In the case of most corporations requiring reorganization the holdings of many security holders are too small to make possible independent action for their own protection. This has brought about the formation of committees for their protection. The history of corporate reorganizations before the adoption of Section 77B reveals too many instances of committees, often self constituted, formed ostensibly to protect security holders but actually serving their own or other private interests at the expense of those they were appointed to serve. One of the purposes of the Bankruptcy Act as amended is to assure such security holders that, so far as the court is able to ascertain after hearing, any committee permitted to intervene in their behalf is composed of able and honest individuals who are free of conflicting interests and reasonably representative, and may, therefore, reasonably be expected adequately to protect their interests. The act seeks to assure such representation by authorizing such committees to be adequately compensated out of the debtor corporation's

> estate for constructive services rendered in assistance of the formulation and accomplishment of a fair and reasonable plan of reorganization. It should be administered in the light of these underlying purposes."

Surely the rule as stated in the *Steere* case is a most salutary one. Widely distributed security holders must look to the court for guidance and protection. Potts and Boag were guided purely by selfish motives in the conclusion of their sale to Bradley and Murphy. They abandoned those whom they were representing. We submit that this Court should hear and determine the merits of this case. It presents an important question of administration in bankruptcy proceedings which is left in a highly unsatisfactory state by the decision of the Circuit Court.

**STATEMENT REGARDING BRADLEY AND MURPHY.**

Messrs. Bradley and Murphy were parties to the proceedings below. They were both directors and Bradley was President of Higbee at the time of the transaction complained of. It was felt that they should be secondarily liable if Potts and Boag were unable to respond to a judgment rendered against them, the theory being that as fiduciaries, if Bradley and Murphy intended to make concessions to effectuate the Plan of Reorganization, these concessions whether in the form of cash payments or otherwise should have been made to all stockholders and not just to Potts and Boag. However, the lower Courts have held that Bradley and Murphy, having paid the price to Potts and Boag once, should not be required to pay it again. Petitioner has decided to acquiesce in this determination. Consequently Bradley and Murphy have not been made respondents in this Petition.

## STATEMENT REGARDING WILLIAM W. BOAG.

During the course of the appeal in the Circuit Court of Appeals it first came to Petitioner's attention that Respondent Boag had entered the Armed Services. No one representing Boag has appeared to request a stay of proceedings pending his return. However, Petitioner has no desire to cause judgment to be entered against Boag under these circumstances. It would be entirely satisfactory to have the proceedings stayed as to Boag pending his return. No similar disability exists respecting Respondent Petts who was the major participant in the transaction and who derived the major part of the profit from it.

## OPINIONS BELOW.

The opinion of the District Court was not published. It appears in the record at page 252. The Circuit Court of Appeals did not render an opinion but merely issued an order approving the judgment of the District Court. This order has not yet been published, but copies thereof have been appended to the record.

## CONCLUSION.

WHEREFORE, Petitioner respectfully prays the issuance of a Writ of Certiorari.

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